Supreme Court, U.S.
FILED
AUG 11 2000
CLERK

(4)

No. 99-1913

In The

SUPREME COURT OF THE UNITED STATES

TOWN OF NORWOOD, MASSACHUSETTS
Petitioner,

vs.

NEW ENGLAND POWER COMPANY,
NEW ENGLAND ELECTRIC SYSTEM (NEES),
PACIFIC GAS & ELECTRIC COMPANY,
PG&E CORPORATION,

Respondents.

On Petition For Writ Of Certiorari To The
United States Court of Appeals For The First Circuit

REPLY BRIEF OF TOWN OF NORWOOD TO BRIEFS IN OPPOSITION BY RESPONDENTS

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REPLY BRIEF OF TOWN OF NORWOOD TO BRIEFS IN OPPOSITION BY RESPONDENTS

Contrary to Respondents' claims that "the Petition does not pose any novel or important issues" and "the decision below is correct", Op. Br. at 5-8, Petitioner, Town of Norwood ("Norwood"), asserts that the case involves important new issues of vital concern to competition in the electric power industry.

The contentions of Respondents in the "factual and regulatory background" and "proceedings below" are inapplicable to the issues before the Court, as discussed *infra*.

1. The court below's ruling that Sections 1 and 2 of the Sherman Act do not apply to price-fixing and price squeeze imposed by Respondents because of the filed rate doctrine conflicts with decisions of this Court and six circuits

Respondents state that Norwood's petition "does not raise any issues of recurring importance that require this Court to revisit the filed rate doctrine." Op. Br. at 5-6. But since the decision below conflicts with this Court's decisions affirming similar price-fixing as a *per se* violation of §1 of the Sherman Act and other decisions relating to price squeeze under §2 of the Sherman Act holding that FERC has no authority to adjudicate the Federal antitrust laws and six circuit courts of appeal, a review of the decision below is important in order to establish the proper scope of the Federal antitrust laws.

Respondents argue that "the decision below is undoubtedly correct" because the private agreements between Respondents to fix prices "did not involve horizontal 'price-fixing.'" [1] Op. Br. at 7. This directly conflicts with the clear

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[1] Respondents' reference to retail restructuring in Massachusetts and Rhode Island (Op. Br. at 2, 3) as applicable to this case, is incorrect. The new, unregulated standard offer wholesale fixed prices, together with the payment of wholesale stranded costs were submitted solely to FERC, and were beyond the jurisdiction of any state regulatory commissions. Neither Respondents nor the court below ever contended that an antitrust immunity existed under the state action doctrine of *Parker v. Brown*, 317 U.S. 341 (1943).

facts alleged in Norwood's complaint, which alleged that in a meeting on September 30, 1996, NEP, then one of the largest generators and suppliers of electric power in New England, agreed with other electric power suppliers in New England, including U.S. Generating Co., a subsidiary of Pacific Gas/PG&E, one of the largest electric power suppliers in the U.S., to fix the prices for wholesale power for standard offer service to be paid by NEP's major distribution company affiliates, including Mass Electric and Narragansett, for up to twelve years. The complaint alleged that in the early years, the fixed standard offer prices were below the market price for wholesale power in New England, with the result no other entity could effectively compete for NEP/NEES' electric customers for the first four years of open access, and was a division of territories, which could make Norwood, denied such wholesale service, vulnerable to a takeover by NEP/NEES. [2]

Subsequent to that time, the fixed prices would escalate sharply above the projected market price for wholesale power. The complaint alleged that this was a scheme designed to allow NEP to sell its generating facilities at a $500 million profit over book value, because the buyer would be guaranteed a locked-in customer base resulting in a division of territories for a number of years during which all competitors seeking to sell wholesale

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[2] Pet. Supp. App. 63a-64a. The statement by Respondents that the "wholesale standard offer was not made available to Norwood and other municipal utilities because, unlike investor-owned utilities, they had no obligation to permit competitive access to their customers or afford them retail standard offer rates"(Op. Br. at 3) has no relevance to Norwood's claims for price fixing in violation of Section 1 or to price squeeze under Section 2 of the Sherman Act. NEP's denial of below-market standard offer wholesale service to Norwood was a *per se* unlawful division of territories and created an anticompetitive hurdle to Norwood competing for new retail customers to relocate from NEP's affiliates' service areas to Norwood's service area.

power would be unable to compete for the existing customers receiving standard offer service. After four years, as the rates rapidly escalate, the competitors would be out of the market and the purchaser of the generating assets would reap huge profits. Pet. Supp. App. 64a-65a.

The court below never analyzed or applied the numerous decisions by this Court holding that similar factual situations constituted an illegal price fixing scheme in violation of Section 1 of the Sherman Act. Pet. for *Cert* at 13. These principles have been reconfirmed by this Court in *Palmer v. BRG of Georgia*, 498 U.S. 46 (1990), which rejected a similar claim to that relied upon by the court below that an allocation of markets by competitors is not unlawful unless the market in which the two previously competed is divided between them and cited its decision in *United States v. Socony Vaccum Oil Company*, 310 U.S. 150 at 223 as follows:

> We explained that '[u]nder the Sherman Act a combination formed for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilizing the price of a commodity in interstate or foreign commerce is illegal *per se*.'"

498 U.S. at 48.

Respondents' contention that the court below properly dismissed Norwood's price squeeze claims (Op. Br. at 7-8) is also defective. Their claim that a price squeeze only applies when one of the rates involved was not subject to Federal regulation (Op,. Br. at 7-8), conflicts with the express holdings of six separate circuit courts of appeal which also cited this Court's rulings in *California, Otter Tail,* and *Cantor*.

In *Cost Management Services v. Washington Natural Gas*, 99 F.3d 937, 945-46 (9th Cir. 1996), an antitrust action was brought to challenge two rates, both filed at the same regulatory commission as creating a price squeeze in violation of Section 2 of the Sherman Act. The ninth circuit made a thoughtful review of the filed rate doctrine cases by the Supreme Court and concluded that the filed rate doctrine did not apply:

> . . . WNG is essentially asking us to extend Keogh to preclude rate-related suits brought by competitors, as opposed to customers, of regulated entities. The weight of authority, and the better-reasoned authority, supports CMS's argument that Keogh simply does not apply to such suits. *See, e.g.*, [P. Areeda & H. Hovenkamp], *Federal Antitrust Policies*, §19.6 at 660 ("Most courts correctly find that Keogh does not apply to *competitor* suits – for example, suits challenging filed rates as predatory pricing") . . .
>
> The Second, Third and Eighth Circuits have all held that Keogh does not preclude rate-related suits brought by competitors of regulated utilities. *See, In re Lower Lake Erie Iron Ore Antitrust Litigation*, 998 F.2d 1144 (3rd Cir. 1993), *cert dismissed*, 510 U.S. 1021, 114 S.Ct. 625, 126 L.Ed.2d 589 (1993); *City of Kirkwood v. Union Electric Co.*, 671 F.2d 1173, (8th Cir. 1992), *cert. denied*, 459 U.S. 1170, 103 S.Ct. 814, 74 L.Ed.2d 1013 (1983); *City of Groton v. Connecticut Light & Power Co.*, 662 F.2d 921, 929 (2d Cir. 1981) ("An anticompetitive practice embodied in a tariff

> may violate the antitrust laws if it . . . impacts upon competitors as opposed to customers."); *Essential Communications Sys., Inc. v. American Tel. & Tel. Co.*, 610 F.2d 1114, 1121 (3rd Cir 1979),

Similar results have been reached by the Seventh Circuit and First Circuit in upholding antitrust cases for price squeeze under §2 of the Sherman Act based upon wholesale rates filed with the Federal Energy Regulatory Commission. Neither has used the distinction used by the court below that "they involve challenges to the combination of a federally-regulated wholesale rate and a retail rate that was not subject to federal regulation." In *City of Mishawaka v. Indiana and Michigan Electric Co.*, 560 F.2d 1314 (7th Cir. 1997), *cert. denied*, 436 U.S. 922 (1978), the Seventh Circuit held that the filed rate doctrine did not bar adjudication by the federal courts of a price squeeze under Section 2 of the Sherman Act based on a wholesale rate filed at the FERC, even though the Commission had jurisdiction to consider price discrimination between a wholesale and retail rate under the Federal Power Act. 560 F.2d at 1318-19, *cert. denied*, 436 U.S. 922.

The First Circuit in *Town of Concord, Mass v. Boston Edison Company*, 915 F.2d 17 (1st Cir. 1990), *cert. denied*, 499 U.S. 931 (1991) (Breyer, J.) has confirmed that the district court has jurisdiction to consider price squeeze claims under Section 2 of the Sherman Act despite the fact that the wholesale rate involved had been filed with the Federal Energy Regulatory Commission, based on principles not related to whether another rate involved is subject to the jurisdiction of retail agencies:

> The basic legal principles that govern this monopolization case are well settled. Even though Boston Edison is a regulated firm, it has

> no blanket immunity from the antitrust laws. *See Otter Tail Power Co. v. United States*, 410 U.S. 366, 372-75 . . . (1973); *see also, Cantor v. Detroit Edison*, 428 U.S. 579, 596 n.35 . . . (1976); *Gulf States Utils. Co. v. FPC*, 411 U.S. 747, 758-59 . . . (1973). The antitrust law relevant in this case makes it unlawful for a firm to "monopolize . . . any part of the trade or commerce among the several States." Sherman Act Section 2, 15 U.S.C. §2(a).

915 F.2d at 21. *See also, Northeast Utilities Service Co. v. FERC*, 993 F.2d 937, 947 (1st Cir. 1993).

All of these precedents, including six different circuits, have confirmed that a claimed price squeeze violation of §2 of the Sherman Act based on a rate filed at FERC is not subject to dismissal under the filed rate doctrine, directly contrary to the grounds stated by the court of appeals below. This imposes a major new split among the circuits which is important for this Court to resolve.

2. The court below's ruling that FERC's deregulation of power sales does not affect immunity under the filed rate doctrine is an important new issue of law

Respondents contend that the mere filing of market-based rates grants immunity because they were "filed with FERC" (Op Br. at 7). FERC has ruled that because of deregulation of power supplies, it simply accepted the private fixed price and contract termination agreements between parties without scrutiny or analysis as previously performed under its long-established cost of service just and reasonable standards of

the Federal Power Act. *New England Power Co.*, 82 FERC at 61,665.

If the summary dismissal below of Norwood's claims under §1 and §2 of the Sherman Act under Rule 12(b)(6) stands, the price fixing and price squeeze prohibitions of the Sherman Act are no longer relevant to agreements by private parties who will be free to fix anticompetitive prices for the future. This will result in a division of territories controlled by private parties precluding any competition to customers therein. As such, deregulation poses an important new issue as to antitrust immunity at FERC under the filed rate doctrine.

3. The court below's holding that the "antitrust savings clause" enacted by Congress in the Energy Policy Act of 1992 granting FERC authority to order open access in Order 888 does not apply, is important and incorrect

Respondents' argument that the savings clause does not apply to any rate setting power of the FERC is in error. The amended 16 U.S.C. §824k(a) of the Federal Power Act expressly authorized the setting of just and reasonable rates for wholesale transmission services, which provided an underlying basis for FERC's Order 888 under which Respondents crafted these anticompetitive agreements. The plain language and legislative history of the 1992 Act, in effect confirmed this Court's decisions in *California* and *Otter Tail*, as well as the decisions by the circuit courts cited in 1 above which were the controlling law denying immunity on the basis of the filed rate doctrine to such antitrust issues.

4. The court below's ruling that this Court's *Square D* decision does not allow declaratory and injunctive relief under §1 of the Sherman Act is important and incorrect

Respondents claim that the court's denial of such relief because "any meaningful relief . . . would require the alteration of tariffs" (Op. Br. at 8) directly conflicts with the affirmance by this Court in *Square D* of the Second Circuit's decision by Judge Friendly holding to the contrary, citing *Georgia v. Pennsylvania R.R.*, 324 U.S. 439, 455 (1944) where this Court "dismissed the damage claims on the authority of *Keogh* but went on to hold that the state could maintain a suit to enjoin the alleged rate fixing conspiracy." *Square D. Co. v. Niagara Frontier Tariff Bur.* , 760 F.2d 1347 at 1358, 1364-1366 (2d Cir. 1985), *affirmed in relevant part*, 476 U.S. 409, 422 n.28 (1986).

5. The court below improperly dismissed Norwood's complaint for breach of contract under Rule 12(b)(6) without discovery, summary judgment procedures, or trial, contrary to long-standing precedents of this Court

Respondents assert that the "power contract only obligates NEP to supply Norwood pursuant to its FERC Tariff No. 1, filed with FERC as [it] may be amended from time to time." Op. Br, at 8. This directly conflicts with the plain language of the power contract alleged in the complaint that "In the event of any conflict between the provisions of the Contract and the provisions of NEP's FERC Tariff, the provisions of this Contract shall control." NEP's unilateral filing of a $78 million contract termination charge against Norwood twice as high as that to its affiliates (who alone were subject to stranded cost

charges under Order 888), directly conflicted with the express language of the contract requiring Norwood to pay only for electric service provided by NEP to Norwood, which precludes any unilateral claim by NEP for liquidated damages for power not delivered. Pet. Supp. App. 61a-62a. The court below never addressed this allegation when it dismissed Norwood's complaint under Rule 12(b)(6), and disregarded the allegations of the complaint as to the proper meaning of "Tariff No. 1" as requiring a cost of service rate, not the converted fixed rate ordered by the FERC no longer supported by NEP's cost of its divested generating plant, and the allegations as to "frustration of purpose" alleged in the complaint based on NEP's divestiture and termination of equal cost of service regulation to its affiliates, which was the underlying premise of the 1983 Antitrust Settlement Agreement and Power Contract. The court also disregarded Norwood's affidavits and its motion to amend the complaint which the district court admittedly never considered. Pet. App. 33a.

The rulings below clearly conflict with the well-established rule in *Jenkins v. McKeithen*, 395 U.S. 411, 421-422 (1969) ("For the purposes of a motion to dismiss, the material allegations of the complaint are taken as admitted . . . the complaint is to be liberally construed in favor of the plaintiff. . . . The complaint should not be dismissed unless it appears that appellant could 'prove no set of facts in support of his claim which would entitle him to relief.'"); and *Square D Co. v. Niagara Frontier Tariff Bur.*, 760 F.2d 1365-66 (2d Cir. 1985), *affirmed in relevant part*, 476 U.S. 409 (1986) (opportunity to amend should be granted).

CONCLUSION

The petition should be granted.

Respectfully submitted,

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August 11, 2000

SUPPLEMENT TO APPENDIX

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MASSACHUSETTS

TOWN OF NORWOOD, MASSACHUSETTS 566 Washington Street Norwood, Massachusetts 02062 Plaintiff, v. NEW ENGLAND POWER CO. 25 Research Drive Westborough, Massachusetts 01582 and NEW ENGLAND ELECTRIC SYSTEM (NEES) 25 Research Drive Westborough, Massachusetts 01582 and PACIFIC GAS & ELECTRIC COMPANY 77 Beale Street San Francisco, California 94105 and	) Case 97-CV10818-PBS))Jury Trial Requested

PG&E CORPORATION)
One Market, Spear Tower Suite 2400)
San Francisco, California 94105)
)
Defendants.)

SECOND AMENDED COMPLAINT

Plaintiff, the Town of Norwood, Massachusetts, a municipal corporation organized and existing under the laws

Norwood terminating service under NEP's dictated 10-year frozen Tariff 1 proposal.[1]

10. On March 18, 1998, NEP, in a filing to the FERC, agreed to Norwood's change of supplier but, despite NEP's then confirmed position as an unregulated market-based power supplier not subject to the FERC's regulated cost of service ratemaking, filed a purported amendment to its Tariff 1 at FERC, applicable only to Norwood, which seeks to require Norwood to pay NEP $78 million in charges related to its divested power supply facilities. NEP's proposed amendment breaches the Power Contract approved by the Decree and Order of April 12, 1983, which contains no such authorization. The Power Contract requires only that NEP provide "all-requirements electric service to Norwood under NEP's FERC tariff, which NEP agrees to provide." That Power Contract expressly provides that "in the event of any conflict between the provisions of NEP's FERC Tariff, the provisions of this Contract shall control." NEP's termination of the required service by selling its low cost power supply facilities, converting Norwood's contract to a fixed price from cost based, and terminating equal service to Norwood as that provided to its large affiliates, bars it from seeking other compensation for non-performing, divested power supply facilities through a tariff amendment inconsistent with the basic Power Contract. NEP's filing as a market-based supplier was not based on any cost of service regulatory standard and does not constitute a filed rate to give it immunity under the Federal antitrust laws. The filing, to the

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[1] - See NEP letter of March 9, 1998 to Norwood, Appendix B hereto.

extent it seeks stranded costs, is unauthorized since the Commission's Regulations do not permit a seller (NEP) to recover any stranded costs where the buyer (Norwood) takes transmission service from another utility namely, Boston Edison Company. 18 C.F.R. § 35.26 (a) and (b)(i). The Settlement Agreement and Power Contract approved by this Court's Decree and Order of April 12, 1983 expressly provide that Norwood is a transmission customer of Boston Edison Co. Boston Edison was required to wheel power to Norwood in an antitrust settlement agreement approved by the Court in April 1980. The $78 million in new charges would require Norwood to pay NEP over $40 million more for wholesale power than NEP's affiliates would pay under the ("Standard Offer"), is an attempt to raise Norwood's cost of providing retail service and will (1) cripple Norwood in its retail competition with NEP's distribution affiliates, and (2) render the Norwood distribution utility vulnerable to hostile takeover by NEP's parent, NEES.

11. By agreeing to transfer all of NEP's non-nuclear generation assets and purchased power contracts to an unregulated business enterprise and, at the same time, agreeing to fix "Standard Offer" prices for wholesale sales by NEP and its assigns to its affiliates (while refusing to offer such prices to Norwood), from this same unregulated enterprise for up to twelve years at an agreed upon, fixed price structure, the Defendants are, by private agreement, effectively converting a regulated monopoly into an unregulated monopoly. Subsequent to the generation asset sale by NEP to the control of defendant Pacific Gas & Electric Co., and its new parent PG&E Corp ("PG&E"), the sale of over 95% of the requirements wholesale power in New England to NEP's affiliates will be unregulated by the FERC under the terms of the "Stipulation and Agreement" of

September 30, 1996. Moreover, the fact that the purchaser is paying $500 million over book value for NEP's generating plant means that it must anticipate charging prices for power in the future that will exceed the present regulated prices set by the FERC for NEP, which are based on NEP's book value cost-of-service.

12. As part of the proposed generation asset sale at a premium of $500 million over book value, NEP, in conjunction with others, has agreed to fix the prices at which PG&E will sell back electric power at wholesale to NEP's affiliates for their existing retail customers. These agreed upon prices and are identical to those contained in the Stipulation and Agreement of September 30, 1996 for "Standard Offer Service" in Section 5.1:

Calendar Year	Price Per Kilowatt Hour
1998	3.2 cents
1999	3.5 cents
2000	3.8 cents
2001	3.8 cents
2002	4.2 cents
2003	4.7 cents
2004	5.1 cents
2005	5.5 cents
2006	5.9 cents
2007	6.3 cents
2008	6.7 cents
2009	7.1 cents [2]

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[2] The fixed prices from 1998 to 2004 are for both Mass. Electric and Narragansett, which are competitors with

13. These fixed prices escalate by 60% over the seven-year period 1998 to 2004, and 122% through 2009. However, for the first four years, these fixed prices are substantially below the wholesale market prices in New England. They are below the prices Norwood was able to obtain in that market in its new contract with NU, the lowest bidder. This price fixing gives NEP's affiliates and NEES' subsidiaries an anticompetitive advantage over Norwood, by allowing NEP's affiliates to have a lower wholesale price than the market price. This allows NEP and its affiliates and NEES to retain their present customers and attract Norwood's customers for the initial four years. NEP and NEES refused to make the Standard Offer Prices available to Norwood.

14. After the four years in which most customer relationships will be set, the fixed Standard Offer Prices are well in excess of reasonably anticipated competitive market prices and greatly exceed cost-of-service prices for NEP's non-nuclear generating capacity. These high price levels in a largely captive market explain why PG&E agreed to pay NEP a $500 million premium for these generation assets.

15. This pricing agreement establishes privately-fixed benchmark prices under which virtually all of NEP's and NEES' existing retail customers, can purchase electric power

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Norwood for new customers or relocation of existing customers. The fixed prices from 2005 to 2009 apply to NEP's affiliate Narragansett.

at below market prices [3] for the first four years, and thus will exclude other suppliers from the market and prevent Norwood from attracting customers to its system and disadvantage Norwood in retaining its customers. After the first four years, the price fixing will also establish an inflated future reference point for all electricity sellers in the NEP control area. That is so because, as all potential sellers will know, the lion's share of regional power requirements in the NEP control area must necessarily come from these very generating plants for many years. Network voltage and stability requirements, capacity import limitations, and limited in-area alternative resource availability all mean that it will be physically impossible to supplant most of the output of these plants in the foreseeable future. Because of these basic engineering facts, the Defendants' above-cost and above-market price fixing agreement will not be vulnerable to the competitive market discipline of new entry, and will actually serve as a benchmark to inflate the future offering prices that may be made by those potential new entrants who are able to gain limited access to the market. The inevitable effectiveness of this price fixing agreement in what will necessarily continue to be a largely captive (but unregulated) geographic market explains why NEP was able to obtain and why PG&E was willing to pay a $500 million premium for the exclusive purchase of all of NEP's non-nuclear generating assets and wholesale power purchase contracts. Norwood submits that this is an unlawful price fixing agreement, in violation of Section 1 of the Sherman Act, U.S.C. § 1, which

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[3] NEP's distribution affiliates may also buy a portion of their Standard Offer requirements from other generators to the extent that it may be available at lower prices, but, as explained herein, this is likely to be minimal.

will sustain prices well above a competitive market price level.

16. The FERC has confirmed that the "Standard Offer Prices" fixed by NEP and PG&E are not based on FERC regulated cost of service, but are derived from NEP's and PG&E's power to enter market-based rates. *New England Power Co.*, 82 FERC ¶ 61,179 at 61,665 (1998). This precludes any claim of antitrust immunity, because the rates contained therein are not FERC approved cost-of-service based rates but are rates determined by the private parties to the agreement on a discriminatory, non-regulated basis.

17. NEP's filing of a purported amendment to its abandoned Tariff 1 service, applicable only to Norwood, to charge it not for any power supply but for NEP's divested power supply facilities, conflicts with the Settlement Agreement and Power Contract approved by this Court's Decree and Order of April 12, 1983 and conflicts with Sections 1 and 2 of the Sherman Act and Section 3 of the Clayton Act. NEP's imposition of a new substantial penalty payment for alleged "stranded costs" upon Norwood, which is designed to force Norwood to underwrite NEP's proposed divestment plan even though it is NEP, not Norwood, that has made service impossible under the existing Power Contract by effectively terminating Tariff 1 service whereby Norwood could receive the equal wholesale power supply as that provided by NEP to its affiliates. The stranded costs of $78 million which NEP unilaterally filed against Norwood alone at the FERC, is approximately twice as high, proportionately, as the charges NEP agreed to with its subsidiary Mass. Electric and Narragansett. Norwood submits this stranded cost penalty payment is an unlawful restraint of trade arrangement and price squeeze which seeks to improperly

raise Norwood's cost of providing retail electricity from accessing competitive markets for replacement power.

18. The foregoing acts by defendants violate Section 7 of the Clayton Act, 15 U.S.C. § 18, Section 1 of the Sherman Act, 15 U.S.C. § 1, Section 2 of the Sherman Act, 15 U.S.C. § 2, and Section 3 of the Clayton Act, 15 U.S.C. § 14.